LABORATÓRIO DE INVESTIMENTO SOCIAL

FUNDAÇÃO CALOUSTE GULBENKIAN

IES SOCIAL BUSINESS SCHOOL

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RESEARCH NOTE #2

FUNDAMENTALS OF SOCIAL INVESTMENT

2014

This research note was written by Joana Cruz Ferreira and António Miguel, with the scientific supervision of Professor Filipe Santos from INSEAD. The aim is to provide readers with a simple and clear introduction to the concept of social investment and its potential in Portugal.

SOCIAL INVESTMENT LAB

The Social Investment Lab is an initiative promoted by the IES-Social Business School and the Calouste Gulbenkian Foundation in partnership with Social Finance UK. It is intended to be a leading knowledge centre in the area of social investment, seeking to disseminate international best practice and innovative financial instruments, and to study its applicability to Portugal.

INTRODUCTORY NOTE FROM THE CALOUSTE GULBENKIAN FOUNDATION

The Gulbenkian Human Development Programme encourages and facilitates the inclusion of the most vulnerable groups in society, through a commitment to social innovation, entrepreneurship and empowerment of people and organisations as keys to development.

There are in Portugal and the Portuguese-speaking world a large number of high impact projects facing numerous financial difficulties which prevent them from achieving their full potential.

Fortunately, financial innovation in recent years has come up with new solutions and tailored them to the specific needs of social organisations and entrepreneurs, particularly in Anglo-Saxon countries. These innovative financial mechanisms are intended to increase the amounts available and diversify sources of capital to finance the social sector.

The main social problems - e.g. the number of children in care, unemployment, school drop-out rates, homelessness, criminal recidivism, social isolation of the elderly and so on - represent a huge economic and social cost. On one hand, we are fortunate to have organisations and social entrepreneurs who devote their effort, skills and professional lives to finding solutions to mitigate these social challenges. On the other hand, there is a lack of appropriate financial instruments to support these entities in the long run and ensure financial sustainability, in order to maximise their impact and improve the quality of life of their beneficiaries.

Calouste Gulbenkian Foundation’s support, through the Gulbenkian Human Development Programme, for the Social Investment Lab is fully aligned with our mission and aims to propose solutions for those working with vulnerable populations, so that they can do it in a way that is increasingly efficient, capable and achieves greater impact.

This is a process of learning together, with the involvement of key players in the financial, social and public sectors, to propose solutions that enhance the quality of life of the most vulnerable populations, reduce the level of poverty and strengthen social cohesion.

FUNDAMENTALS OF SOCIAL INVESTMENT

"THE WHOLE IS GREATER THAN THE SUM OF ITS PARTS" – THE INNOVATIVE RESPONSE OF SOCIAL INVESTMENT

According to *the Social Investment Package* recently launched by the European Commission,[1] poverty and social exclusion, long-term unemployment, an ageing population and gender inequalities are some of the biggest social problems of today. Problems like these affect the quality of life of populations, imply a high social and economic cost to the public sector, and therefore to society. Nowadays, a major challenge is to develop solutions to these social problems, so as to reverse the tendency for them to accumulate and prevent the onset of other social problems. This is the key role of the emerging area of Social Innovation and Entrepreneurship for society and has also historically been a central feature of the social sector.

According to the INE Satellite Account for Social Economy, in 2010, the Portuguese social sector employed more than 55,000 organisations.[2] At that time, these accounted for 5.5% of paid employment.[3] Although diverse in their type of activities and area of operation, these entities suffer from a common challenge: lack of financial resources and weak capitalisation, which hinders the performance of their activities and maximisation of impact.

Social Investment is the application of capital into activities, organisations or funds in order to simultaneously obtain a financial return and a value return to society, both of which are monitored and influence investor decision-making. Social Investment is different from business investments in that it uses impact as a criterion, but it also differs from philanthropy since it avoids traditional donations and seeks to support organisations or solutions that are sustainable and that can potentially generate revenue in the pursuit of its mission, to provide a return on investment.

The value proposition of social investment is based on the relationship between different players - investors, social organisations, social entrepreneurs and the public sector - combining resources, experience and knowledge, so that their joint action generates more value than their acting in isolation. This perspective on investment fosters social innovation and promotes a new dynamic of interaction among players: one example is Social Impact Bonds (SIB) which raise capital from investors for social projects,[44] who are paid by the public sector depending on the results achieved and have a strong emphasis on building capacity within the social organisations that implement the project.

A key factor to inform decision-making on social investment projects is impact measurement. There is a need for a rigorous evaluation, to align the needs of organisations and social entrepreneurs with the interests and risk profiles of investors. Impact measurement encourages a greater focus on results, promoting innovation and efficiency in the social sector, facilitating the comparison and detail of different projects.

1- Available at: http://ec.europa.eu/social/main.jsp?langId=en&catId=1044&newsId=1807&furtherNews=yes (Date accessed: 06.02.2014)
2- CASES (2013) Conta Satélite da Economia Social 2010. Lisbon: Cooperativa António Sérgio para a Economia Social.
3- Full Time Equivalent (FTE) jobs
4- For more information, see Social Investment Lab, Research Note # 3/2014 Social Impact Bonds

Social impact: a new variable in the traditional investment equation
Traditional investments include two main components - risk and return - which tend to move in the same direction (i.e. when the risk increases, so does the return required by investors). Social investment is adding a new criterion in the investment decisions: impact, defined as the creation of value for society. From this perspective, the correlation between variables does not have to be negative - the impact and the financial returns are not mutually exclusive. Moreover, financial return does not necessarily imply maximising profit: the investor may require a lower return given the expected impact and risk, which may only cover inflation, or may even take a financial loss in exchange for high impact. The balance between the three variables (risk, return and impact) is achieved through the coordination and alignment of interests between investors and partners, a detailed analysis of the economic and social costs of a project, and the potential impact and financial return.

To summarise, Social Investment involves different stakeholders in the search for innovative answers to today's most challenging problems and the alignment of their interests. Social investment places a strong emphasis on analytical rigour to estimate the economic and social costs associated with each social problem, the savings generated from solving this problem and the value that each solution adds to society. The central focus of social investors is the capitalisation and capacity-building of organisations and projects with the potential of generating high impact, thus focusing on supporting the emerging area of innovation and social entrepreneurship.

"IT'S EASY TO MAKE A DOLLAR, IT IS NOT SO EASY TO MAKE A DIFFERENCE." WHO MAKES A DIFFERENCE IN SOCIAL INVESTMENT?

SOCIAL ORGANISATIONS – THE DEMAND SIDE OF THE SOCIAL INVESTMENT MARKET

According to the Legal Framework for the Social Economy, all institutions of Social Solidarity, Associations, Cooperatives, Mutual Associations and Charitable Foundations are considered social economy or social organisations. Whether or not they operate on a commercial business model, all non-profit organisations that have a social mission and seek to generate impact through their work are included in this category, and could benefit from social investment. Although they are not included in this legal framework, if they adopt a clear social mission that is reflected in its statutes, companies (or departments thereof) may also benefit from social investment (whether private or public limited companies).

Social investment creates incentives for capacity-building of social organisations, in order to better prepare them to receive funding to develop their activities and to maximise the creation of impact.

- **Social Investment FOR social organisations.** Financing of a specific project or initiative, to support social organisations in carrying out their daily work and provision of specific services. This can be used, for example, to acquire goods, mobilise resources and launch a pilot scheme.

- **Social Investment IN social organisations.** If achieved through a capital investment, social investment prepares organisations for a period of extended operations. This can be used to create capital reserve, to finance improvements in processes and training, as well as to finance the organisation overall. Social organisations can also use funding for the acquisition of assets, acquiring new equipment or expanding their facilities. In these cases, social investment supports the organisation growth, offering organisations the opportunity to increase their scale, expand their reach or diversify their range of activities (e.g. a social organisation that works with teens can use funding to expand their monitoring activities in order to support adolescents in transition to adulthood and thus provide a long-term service).

Benefits of Social Investment for social organisations and social entrepreneurs:

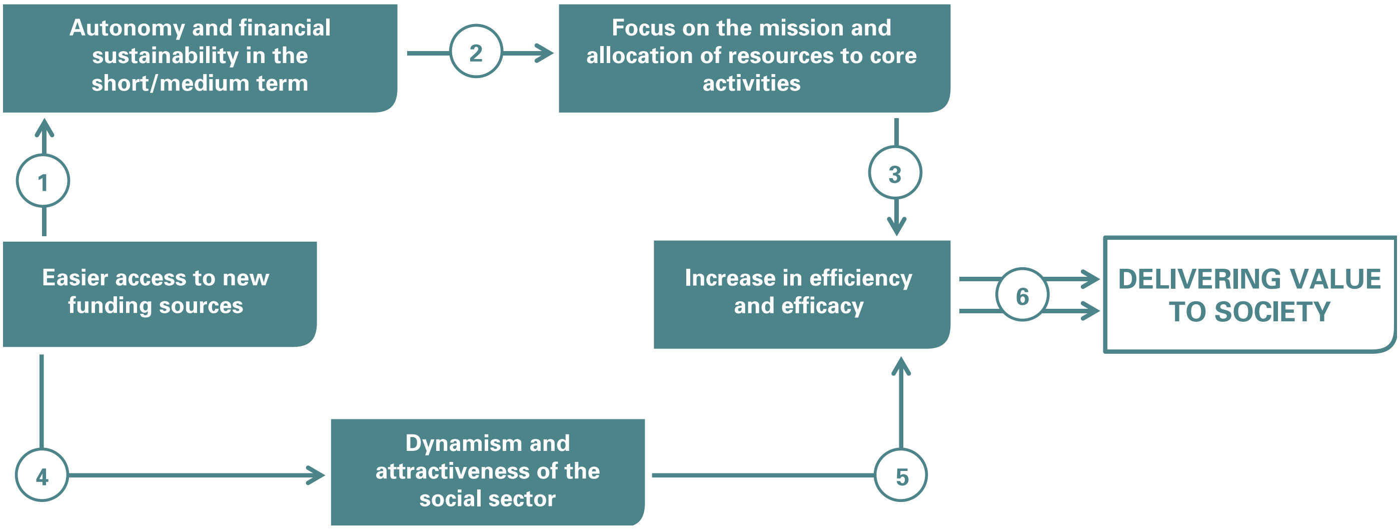


Figure 1 - Benefits of Social Investment for social organisations and social entrepreneurs

The Social Investment Lab believes that the easier the access to financing, the greater the financial autonomy of social organisations and social entrepreneurs (1). The existence of predictable and timely funding facilitates the focus on the social mission and promotes the activities planning for the medium/long term, since organisations are not as pressured to seek external short-term financing (2). By assuming that social investment can be made in the overheads of social organisations, the management focus can be re-oriented towards fulfilling its mission, improving the goods and services provided to beneficiaries and maximising their impact. As a result, organisations and social entrepreneurs meet the challenges of their proposal in a more effectively way and may also gain economies of scale that improve the efficiency of their performance (3).

On the other hand, the existence of new funding sources makes the social sector more attractive and dynamic, so that new organisations seek to enter the sector (4). Organisations and entrepreneurs, until now distanced from the sector by the lack of available capital, are attracted to participate in the market and make their value propositions. The new capital flows encourage competition and collaboration between organisations, stimulating innovation, recruiting talent and tuning service provision. These dynamics accelerate the levels of efficiency and effectiveness (5).

As a concept, regardless of the diversity of investor motivations that may exist, social investment aims ultimately to maximise the value created by social sector (6).

From donations to social investment: The role of Impetus Trust Private Equity Foundation
This Foundation, which operates in the UK, applies the principles of venture philanthropy in building capacity of social organisations and entrepreneurs. This support is specialised within a particular field - organisations that support vulnerable children and youth - in which they have developed expertise and skills. During a 2-3 year period, the organisations supported have followed a path from project funding via donations to the adoption of social investment instruments on a refundable basis. Success stories include organisations like Thinkforward and Teens and Toddlers, which currently fund some of their projects through Social Impact Bonds.

SOCIAL INVESTORS – THE SUPPLY SIDE OF THE SOCIAL INVESTMENT MARKET

Social investors act as holders of financial resources to be applied to social organisations or as channels for resource mobilisation. Foundations, Banks, Financial Institutions, Family Offices, Investment Funds, High net worth individuals and Departments of Corporate Social Responsibility are examples of potential social investors. These can be specialised institutions in the social sector or other already-existing ones operating in the traditional capital markets. The comparison between financial institutions in the social sector and their equivalents in the traditional capital markets, including national and international examples, is shown in Table 1. In both markets, there are institutions with greater appetite for risk which invest in projects at an early stage - venture capital funds and social venture capital funds - and other institutions that have a greater focus on impact, which invest in other development phases of a social project - social investment funds. The importance of organisations such as research agencies and social investment intermediaries should also be highlighted. They promote the market infrastructure and ensure its long-term sustainability.

Traditional institutions of capital markets	Institutions of the Social Investment Market	Examples
Commercial Banks	Social Banks	Triodos Bank
Investment Banks	Social Investment Advisors	Social Finance; Big Society Capital Transforming social investment
Stock Exchange	Social Stock Exchange	BVS Bolsa de Valores Sociais; Impact Investment Exchange Asia Capital Markets for Social Good™
Venture Capital Funds	Social Venture Capital Funds	acumen Fund; IGNIA
Investment Funds	Social Investment Funds	Nesta Impact Investments
Research Agencies and rating	Financial Consulting	NPC New Philanthropy Capital

Table 1: Traditional financial institutions, social financial institutions

Benefits of Social Investment for social investors:

Portfolio diversification. Social investment contributes to a new form of capitalism, promoting a balanced allocation of resources among several players. It offers the opportunity to diversify portfolios by including alternative assets in comparison with those that traditionally make up the portfolio investments of banks. Social investment projects, at an early stage in the market, offer combinations and opportunities for financial return and impact largely unexplored to date.

Creating value in the medium and long term. The time horizon of social investment projects is the medium and long term. This can be signalled by investors to shareholders and customers, reinforcing the extended commitment towards their actions. As a comparative advantage, this shows the intention of investors to provide sustainable responses to the challenges of today, while identifying business opportunities with value to society in various fields.

Involving the community. Social investment is one answer to the increasing priority for organisations and employees for contributing to a better society, and strengthening the social role of the main economic players. Traditional philanthropic investors, such as foundations and high net worth individuals may allocate a portion of their resources to projects that generate financial return and impact, allowing the recycling of these amounts and their subsequent application to other projects in the long-run.

Measuring impact. The consistent and accurate measurement of impact and quantification of social value as a financial return variable is fundamental to social investment projects.Building capacity of social organisations and entrepreneurs in this direction is needed to dispel the notion that investment opportunities in the social sector are scarce and limited. The measurement of results achieved means that investment opportunities are validated, renewed and multiplied.

Social Investment Fund launched by Foundations
In 2008, the Esmée Fairbairn Foundation launched the Finance Fund - a social investment fund worth about 35 million pounds. This fund aims to complement its grants and philanthropy programmes, through investments with an expected return in the long-term.. At the end of the year 2012, the fund had invested about 12 million pounds in 45 medium-term social projects.

IN A TIME OF ECONOMIC 'CRISIS', WHY TALK ABOUT SOCIAL INVESTMENT IN PORTUGAL?

Portugal faces serious accumulation of social problems. These problems affect the sustainability of public finances and functioning of social systems daily and therefore the quality of life of the Portuguese people.

Social investment is intended to be a response to these challenges by leveraging existing capabilities in the social sector, capitalising on the momentum of social entrepreneurship and mobilising existing resources in the public and private sectors. It aims to simultaneously obtain a financial return and social impact, countering the prejudice that these two variables are mutually exclusive. In certain areas this may happen, requiring the unique intervention of commercial investment or public or philanthropic investments, depending on the nature of the problem and the ability of the market to operate efficiently. However, in many other areas it is only the lack of collective imagination that prevents the putting together of solutions and creation of financing structures that can combine expectations of financial return and impact for all parties involved.

Big Society Capital: the role of unclaimed assets
In 2012, Big Society Capital was founded in the UK with 600 million pounds to invest in the creation of a social investment market. Of that available capital, 400 million pounds were from unclaimed assets (including capital from dormant bank accounts) and the remaining 200 million pounds were made available by four retail banks, with the prospect of long-term repayments of the investment. The purpose of this financial institution is to invest in intermediate entities that form the bridge between investors and social projects, with the potential to generate great impact and financial return.

On the demand side, there are over 55,000 social economy organisations in Portugal, representing about 2.8% of gross added value and employing 5.5% of the paid workforce. However, there is a common problem in the industry: they lack adequate financial resources for the specific needs of the sector. The latest data available on the INE Satellite Account for Social Economy shows that associations and other social economy organisations have financing needs worth more than €750 million.[5]

5- Source: CASES (2013) Conta Satélite da Economia Social 2010. Lisbon: Cooperativa António Sérgio para a Economia Social.

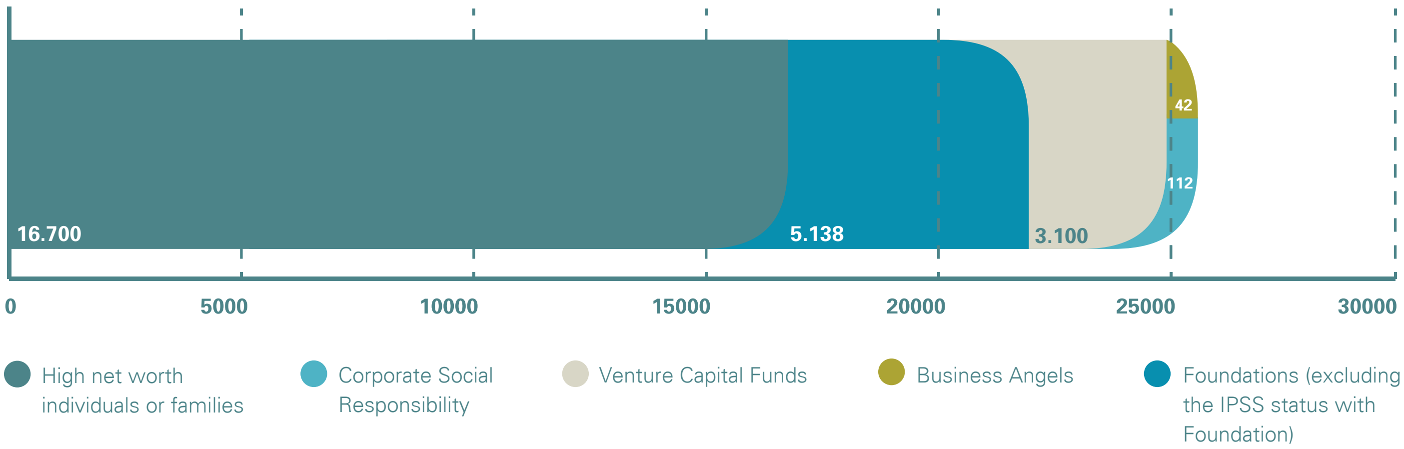
On the supply side, we have identified five categories of potential social investors in Portugal at an initial stage of the market: high net worth individuals,[6] Foundations (excluding the IPSS with Foundation status),[7] Venture Capital Funds,[8] Corporate Social Responsibility budgets,[9] and Business Angels.[10]

Initial calculations from the Social Investment Lab team, based on public information and illustrated in the figures below, suggest that the needs of the demand side of the market could be met by existing potential on the supply side:

- In a scenario where 1% of assets under management by these five categories of investors is allocated to the social sector,[11] **approximately €250 million** could be made available to the sector in the form of investment. This amount **could meet one third of the funding needs of the social sector as expressed by INE.**

- Following the same assumptions, but with 5% of the assets under management of these investors allocated to the social sector, **approximately €1,250 million could be available and tackle the entire net needs for financing the social sector.**

Total assets under management of potential social investors (EUR million)



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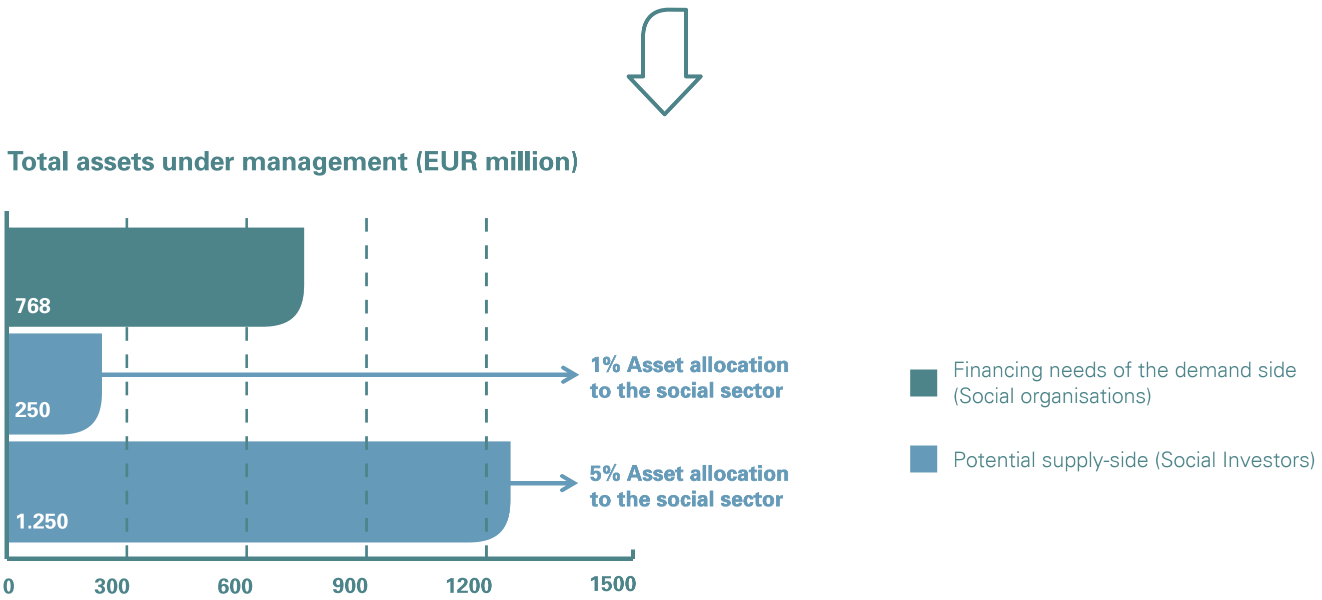

6- Available at: http://www.publico.pt/economia/noticia/americo-amorim-volta-a-recuperar-lideranca-dos-mais-ricos-de-portugal-1614179 (Date accessed: 11/02/2014)
7- Source: SEAP (2010) *Relatório de Avaliação das Fundações*. Lisbon: Secretary of State for Public Administration
8- Source: CMVM (2012) *Relatório Anual da Atividade de Capital de Risco*. Lisbon: Securities Market Committee 9-Source: SDC
9- (2013) Project of reflection, research and debate: The support of the business community. Lisbon: Sair da Casca
10- Consists only of the capital available through the Co-investment Fund. Available at: http://www.fnaba.org (Date accessed: 11/02/2014)
11- For the sake of simplicity, we adopted the term 'assets under management' from a broader perspective, considering private property and Corporate Social Responsibility budgets.

Despite focusing this research note on social investment assuming a logic of simultaneous financial return and impact, it is important to note that there are several types of funding available to social organisations. These vary in investor intention and expectations, in investment maturity and structure and, above all, in the development stage of the social organisation and project in question:

- Funding through donations is especially suitable for social organisations and entrepreneurs at an initial stage, when they are still developing the idea and have little financial ability to repay any kind of investment;

- For social organisations and social entrepreneurs in the process of developing an already tested idea, financing needs may consist of training or investment in organisational overheads, which may be the target of venture philanthropy projects;

- Organisations with promising and innovative services for tackling a specific social problem can test them and create a greater evidence base through Social Impact Bonds;

- In the case of reasonably-sized social organisations in a developed phase, which intends to set up a service or expand their operations geographically, there are impact investing funds which are closer to traditional risk capital instruments - they have a greater focus on financial return, but keep the focus on impact.

The mobilisation of financial resources for the social sector, within a framework whereby financial returns exist alongside impact, promotes greater efficiency in the sector and helps building a foundation of incentives focused on achieving results. The focus on outcomes helps creating a culture of collaboration in the sector; where complementary services get together in order to cope with a particular social problem. The engagement of social investors helps catalysing greater empowerment of the sector alongside a focus on impact measurement.

In Portugal, the social challenges are complex and require analytical rigour and intellectual dedication in order to be solved in a structural way. We believe that social investment, through a closer relationship between the social sector and a greater diversity of capital sources, can contribute to a more resilient, sustainable and higher impact social sector, maximising the value it delivers to society.

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LABORATÓRIO DE INVESTIMENTO SOCIAL

This research note was developed by the Social Investment Lab under the scope of the project "Portuguese Social Investment Taskforce", launched in 2014 with the aim of catalysing the social investment market in Portugal. This one-year project was financially supported by the European Commission, through the program: Supporting the demand and supply side of the market for social enterprise finance.

This piece is part of a series developed by the Social Investment Lab, whose contents should reach organisations, social entrepreneurs, investors and various public sector agencies, and help create key knowledge on social investment. The objectives of the research notes are to identify the needs of the sector, introduce new concepts and instruments, to reflect on what has been done in other countries and to promote discussion about the potential implementation of social investment in the Portuguese situation and the Portuguese-speaking world. We invite readers to ask questions, make suggestions and share ideas via email at investimentosocial@ies-sbs.org.

Funded by the European Union

PARTNERS:

IES – Social Business School
IES-Social Business School is a non-profit association which aims to stimulate innovation, efficiency and the growing impact of transformative projects that break problems traps in our society. The vision of the IES-SBS is to be the benchmark for social entrepreneurship in the Portuguese-speaking world, fostering innovation, knowledge, learning, and social impact. The work of the IES-SBS is focused on training and promoting high potential social entrepreneurship initiatives, along with exceptional organisations and individuals committed to change the world in the most efficient and innovative way. The mission of IES is to Inspire and Empower for a better world, through Social Entrepreneurship.

Calouste Gulbenkian Foundation
Calouste Gulbenkian Foundation is a private Portuguese institution for public use whose statutory aims are the Arts, Welfare, Science and Education. With over 50 years of experience, the Calouste Gulbenkian Foundation works extensively in Portugal and abroad through its own initiatives or in partnership with other organisations, and through the provision of grants and scholarships. The mission of the Gulbenkian Human Development Programme, created in 2009, is to encourage and facilitate the inclusion of the most vulnerable groups in society.

Social Finance UK
Social Finance was established in 2007 and is a non-profit organisation that works with social organisations, investors and the public sector in the development of financial mechanisms tailored to the needs of the social sector. Social Finance launched the first Social Impact Bond in HMP Peterborough, attracting an investment of £5 million from 17 investors, with the aim of reducing the recidivism rate. The Social Finance team consists of experts from the financial, social, public and private sectors. This team has from the start supported the UK Social Investment Task Force, the Commission of Unclaimed Assets and was involved in the creation of Big Society Capital, the UK social bank.